No.87-654 (9)

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1987

NEW ENERGY COMPANY OF INDIANA,
Appellant,

v.

JOANNE LIMBACH
TAX COMMISSIONER OF OHIO,
MARY ELLEN WITHROW, TREASURER OF OHIO,
AND SOUTH POINT ETHANOL,
Appellees.

ON APPEAL FROM
THE SUPREME COURT OF OHIO

BRIEF OF APPELLEES JOANNE LIMBACH, TAX COMMISSIONER OF OHIO, AND MARY ELLEN WITHROW, TREASURER OF OHIO

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QUESTIONS PRESENTED

Whether Ohio Revised Code 5735.145(B) Which Restricts The Subsidy Provided By The Ohio Ethanol Tax Credit To Dealers Which Use Ethanol Produced In Ohio And In Any Other State Which Grant Similar Credits Violates The Commerce Clause.

I. Whether The Ohio Ethanol Tax Credit Scheme Imposes The Type Of Burden On Interstate Commerce Which The Commerce Clause Was Intended To Prohibit.

II. If Ohio Revised Code 5735.145(B) Is Subject To The Strictures Of The Commerce Clause, Is Any Incidental Burden On Interstate Commerce Clearly Outweighed By The Local Benefits To The Health And Safety Of The Peopie Of Ohio Advanced By The Legislation.

A. Is Ohio Revised Code 5735.145(B) An "Economic Protectionist" Measure.

B. Is Ohio Revised Code 5735.145(B) Subject To The Strict Scrutiny Standard In The Absence Of An Absolute Ban On The Sale In Ohio Of Ethanol Produced In States Which Do Not Grant Ethanol Credits To Ohio-Produced Ethanol.

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STATEMENT OF THE CASE

New Energy challenges the constitutionality of Ohio Revised Code 5735.145(B) which was enacted as part of Amended Substitute Senate Bill No. 334, which became

effective on January 1, 1985. That provision reads as follows:

> (B) The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the Tax Commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of credit allowable for qualified fuel containing ethanol produced in Ohio.

New Energy argues that this reciprocity provision violates the Commerce Clause (Art. I, Sec. 8, cl. 3) of the United States Constitution.

The qualified fuel credit referred to in Ohio Revised Code 5735.145(B) is provided by Ohio Revised Code 5735.145(A) against the motor vehicle fuel tax imposed on motor vehicle fuel dealers. Such dealers are allowed a credit for each gallon of ethanol blended with gasoline in not more than a 10% ratio and used, sold or distributed by dealers in Ohio. The amount of the credit per gallon is based on a statutory formula and varies based upon changes in the federal gasohol credit. Ohio Revised Code 5735.145(A)(4). The motor vehicle fuel tax is imposed upon and the ethanol tax credit is available solely to motor vehicle fuel dealers, not ethanol producers.

The ethanol tax credit is available not only for Ohio-produced ethanol which is used to create gasohol. It is also available for ethanol produced in any other state which grants similar tax incentives for ethanol use. Ohio Revised Code 5735.145(B). In fact, at the time the complaint was filed and at the time the reciprocity provision was enacted ethanol produced by every out-

of-state producer which competes in the Ohio market, with the sole exception of New Energy, was eligible for the full Ohio tax credit. The evidence established that these out-of-state competitors have the capacity to fully supply that portion of the Ohio ethanol market presently being filled by New Energy should New Energy withdraw from that market. There is nothing in the record to evidence that South Point Ethanol, the only Ohio producer, had the capacity to expand into any void in the Ohio market. The Ohio Court of Appeals found that the evidence indicates that if New Energy left the Ohio market "the primary beneficiaries would be Illinois and Tennessee producers of ethanol . . . ." J. St. App. 46a. The record fully supports this finding by the Ohio Court of Appeals. One of the Illinois producers (Archer Daniels Midland "ADM") is the largest and most aggresive producer and it has the full capacity to fill any void in the Ohio market. JA 28, ¶17, 77-80. Unlike New Energy's assertions which are based solely on assumptions and speculation, the finding of the Ohio Court of Appeals was based on record evidence.

The use of leaded gasoline in motor vehicles is one of the major contributors to air pollution in this country. 49 Fed. Reg. at 31,036, 31,038 (1984). It is a legitimate goal of both the federal and state governments to reduce the level of pollutants caused by the use of leaded gasoline in motor vehicles. JA 113. Ethanol is the most cost-effective and environmentally benign replacement for lead in gasoline. JA 25, ¶10, 112. It is not disputed that there are major health benefits to the public from replacing lead with ethanol in gasoline. JA 112-113.

Because of these benefits, and because ethanol provides an alternate renewable source of fuel which decreases the dependency on foreign oil and a market for the country's surplus corn, both the federal government and many states have enacted legislation providing incentives to encourage the production and use of ethanol. The majority of state incentive programs use tax credits to subsidize the use of ethanol. The ethanol market

in Ohio would not exist or would at least be substantially smaller without the subsidy provided by Ohio's tax credit because without the credit ethanol could not compete with gasoline. JA 64-65, 73-77, 100, 147-149.

One of the purposes of the Ohio General Assembly in enacting Ohio Revised Code 5735.145(B) was to provide a cleaner and safer environment by encouraging the use of ethanol as a substitute for lead in gasoline not only in Ohio but in all states. The Ohio Supreme Court found that Ohio Revised Code 5735.145(B) was not an "economic protectionism" measure, but rather was intended to effect this legitimate state purpose. J. St. App. 6a. It is undisputed that the providing of tax incentives is the best method of encouraging such use. JA 25-26, ¶11.

The record is devoid of any evidence supporting New Energy's repeated assertion that the sole purpose of Ohio Revised Code 5735.145(B) was a parochial attempt to protect local ethanol producers against out-of-state competitors. The record fails to establish that this was either the purpose or the effect of the reciprocity provision.

SUMMARY OF ARGUMENT

I. Ohio Revised Code 5735.145(B) is not invalid under the Commerce Clause. That provision is a part of Ohio's statutory scheme intended to encourage the use of ethanol as a substitute for lead in gasoline by providing a subsidy in the form of a tax credit. One of the purposes for encouraging such use of ethanol is to advance the health and welfare of Ohio's citizens by providing a cleaner and safer environment. The challenged reciprocity provision of the statutory scheme restricts the tax credits provided to dealers to ethanol produced in Ohio or any other state which provides similar credits for the use of Ohio-produced ethanol.

Even if this reciprocity provision has the effect of reducing the flow of ethanol in the interstate market, it

is not in violation of the Commerce Clause because the action taken by Ohio through its statutory scheme is not the type of action that is subject to the restraints of the Commerce Clause. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976); *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980); *White v. Massachusetts Council of Const. Employers*, 460 U.S. 204 (1983).

These cases hold that when a state or local government has entered the market as a participant rather than a regulator it is not subject to the strictures of the Commerce Clause. As did Maryland through its bounty scheme in *Alexandria Scrap*, Ohio through its ethanol tax credit has entered the market through a state-funded subsidy to stimulate the market by making ethanol more economically attractive as an alternative for lead in gasoline. Ohio has not attempted to regulate the market, it has simply exerted a market force to make ethanol competitive with gasoline. The Ohio legislation falls directly under the rule in *Alexandria Scrap*.

Nor should the strictures of the Commerce Clause apply to state subsidy programs which utilize various methods to encourage local industry in a market which owes its existence, in whole or in sustantial part, to the subsidies provided under the state program. Thus, even if Ohio's program favored Ohio producers over out-of-state producers, it should not be invalidated under the Commerce Clause because the Ohio ethanol market would not exist, or would be substantially smaller, without the subsidy program.

II. Even if the Ohio statutory scheme is subject to the restraints of the Commerce Clause, the reciprocity provision is not invalid under that clause. The reciprocity provision is not an "economic protectionist" measure nor does it effect an absolute ban on the flow of ethanol in the interstate market. Therefore, the provision is valid under the Commerce Clause unless the incidental burden on interstate commerce is clearly excessive in relation to the putative local benefits advanced by the provision.

As the Ohio Supreme Court properly found, the reciprocity provision passes this test. The provision is intended to effectuate a compelling state interest, a healthier and safer environment, and any incidental burden on interstate commerce effected by the provision is not clearly excessive in relation to the local benefits to the health of the people of Ohio advanced by the legislation.

The reciprocity provision is not an "economic protectionist" measure designed to provide a commercial advantage to Ohio ethanol producers over all out-of-state producers. The provision does not restrict the ethanol credit to Ohio-produced ethanol. It is available for the use of ethanol produced in any state which grants incentives similar to the Ohio scheme. The purpose of the provision is to encourage other states to enact similar ethanol incentive programs. Such incentives are essential to enable ethanol to compete economically in the marketplace with gasoline. The ethanol industry cannot survive without such incentives.

The record contains no evidence of a discriminatory purpose behind the reciprocity provision nor does it establish that it has had a discriminatory effect. Only one interstate participant, New Energy, has been shown to have been adversely affected by the provision. There is no evidence that any of the out-of-state producers have been disadvantaged or that the sole Ohio producer has been advantaged. This is not a discriminatory effect. *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981); *Exxon Corp. v. Maryland*, 437 U.S. 117 (1978).

The Ohio reciprocity provision, unlike the provisions in the cases relied on by New Energy, does not result in an absolute ban on the flow of a product in interstate commerce. No ethanol producer, including New Energy, is prohibited from selling or distributing ethanol in Ohio. Because of the absence of an absolute ban on the interstate flow of ethanol, the reciprocity provision is not subject to the strict scrutiny standard applied by this Court in cases involving absolute bans on interstate commerce.

ARGUMENT

OHIO REVISED CODE 5735.145(B) WHICH RESTRICTS THE SUBSIDY PROVIDED BY THE OHIO ETHANOL TAX CREDIT TO DEALERS WHICH USE ETHANOL PRODUCED IN OHIO AND IN ANY OTHER STATE WHICH GRANTS SIMILAR INCENTIVES DOES NOT VIOLATE THE COMMERCE CLAUSE.

I. The Reciprocity Provision Of The Ohio Ethanol Tax Credit Statute Does Not Impose The Type Of Burden Which The Commerce Clause Sought To Prohibit.

In 1981, the Ohio General Assembly enacted Ohio Revised Code Section 5735.145 (139 Ohio Laws 1731) providing a credit against the Ohio motor vehicle fuel tax imposed on motor vehicle fuel dealers for each gallon of ethanol that is blended with gasoline and is used, sold or distributed by the dealer as motor vehicle fuel. At the time the ethanol tax credit was first enacted, the credit was available to dealers regardless of the source of the ethanol.

The subsidy provided to dealers by the tax credit was intended as an incentive to encourage Ohio dealers to use ethanol as a substitute for lead in gasoline. Such use of ethanol was encouraged because of the significant health benefits that will result from its use in place of the highly pollutant lead. J. St. App. 6a; JA 25-27, 136.[1] New Energy agrees that encouragement of the use of ethanol as a substitue for lead in gasoline is a legitimate goal for state governments. JA 112-113. The federal government has also determined that such use of ethanol

[1] The Ohio General Assembly may well have had other purposes in mind in deciding to enact the credit: providing an additional market for the sale of corn, the main raw material used to produce ethanol, and producing an alternate and renewable source of fuel, thereby reducing the dependency on foreign oil.

is worthy of encouragement and has provided various incentives to its use. JA 25-26, ¶11.

The subsidy provided to dealers by the tax credit is necessary in order to make the use of ethanol economically competitive *vis a vis* gasoline, because ethanol costs more to produce than gasoline. JA 65-66, 73-77, 100, 147-149. As New Energy has admitted in its brief (at 6, n.2), absent the Ohio credit ethanol is economically unattractive to motor vehicle fuel dealers.

While initially the state subsidy was made available to dealers for the use of ethanol without any restriction regarding its source, the Ohio General Assembly amended its ethanol tax credit statute by adding, *inter alia*, the reciprocity provision that is the subject of the constitutional challenge at issue in this case. This provision, Ohio Revised Code 5735.145(B), effective January 1, 1985, provided that the credit was not available for the use of ethanol produced outside Ohio unless the state in which it was produced provided similar credits for the use of Ohio-produced ethanol.

The State appellees ("State") do not dispute that the practical effect of this amendment, subsequent to Indiana's repeal of its ethanol credit, has been to adversely affect New Energy's competitive position in the Ohio market because Ohio dealers will not be eligible for the Ohio subsidy for using ethanol produced by New Energy.[2] The evidence in the record does not, however, indicate that the reciprocity provision effected a reduction in the total movement of ethanol in the interstate market.[3] Ethanol produced by all other out-of-state producers competing

[2] The record does not establish that any other competitor in the Ohio ethanol market was adversely affected by the amendment nor does it establish that the sole Ohio producer, appellee South Point Ethanol, has benefited from New Energy's probable loss of its market share in Ohio.

[3] See *infra*, Part II. A., at 22-23.

in the Ohio market continued to qualify for the subsidy. JA 28, ¶17.

However, even if the reciprocity provision is found to have the effect of reducing to some extent the flow of ethanol in the interstate market, the provision is not violative of the Commerce Clause because any such burden effected by the limitation on the goods for which the Ohio subsidy is made available is not the type of barrier sought to be prohibited by the Commerce Clause. The ethanol credit reciprocity provision falls squarely under the rule established by this Court in *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976), and reaffirmed in *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980) and *White v. Massachusetts Council of Const. Employers*, 460 U.S. 204 (1983).

In *Alexandria Scrap*, this Court considered a Commerce Clause challenge to a Maryland statutory scheme which provided a state funded bounty to automobile scrap processors to encourage the destruction of automobile hulks abandoned in the State. The part of the statutory scheme challenged was an amendment which required the scrap processors to submit title documentation to the State to qualify for the bounty. This amendment imposed more burdensome documentation requirements on out-of-state scrap processors than on in-state processors. The Court found that the amendment gave Maryland scrap processors an advantage over out-of-state processors. *Id.*, at 802. "The practical effect was substantially the same as if Maryland had withdrawn altogether the availability of bounties on hulks delivered by unlicensed suppliers to licensed non-Maryland processors." *Id.*, at 803, n. 13. This Court concluded that the result of the amendment was a reduction in the movement of automobile hulks in interstate commerce. *Id.*, at 803.

Although this Court found that the challenged amendment resulted in such a reduction, it upheld the Maryland statute because, this Court held, the action taken by the Maryland statutory scheme was not "the kind of

action with which the Commerce Clause is concerned." *Id.*, at 805. This Court distinguished Commerce Clause cases in which a state burdened interstate commerce by prohibitions or regulations:

> The common thread of all these cases is that the State interfered with the natural functioning of the interstate market either through prohibition or through burdensome regulation. By contrast, Maryland has not sought to prohibit the flow of hulks, or to regulate the conditions under which it may occur. Instead, it has entered into the market itself to bid up their price.

Id., at 806. As this Court expressly noted, it had never "been asked to hold that the entry by the State itself into the market as a purchaser, in effect, of a potential article of interstate commerce creates a burden upon the commerce if the State restricts its trade to its own citizens or businesses within the State." *Id.*, at 808. This Court answered by holding that "[w]e do not believe the Commerce Clause was intended to require independent justification for such action." *Id.*, at 809.

Alexandria Scrap renders New Energy's reliance on prior Commerce Clause cases nugatory because it explicitly distinguished between the burden imposed in any of the Court's prior cases and that imposed by the Maryland statutory scheme:

> But no trade barrier of the type forbidden by the Commerce Clause, and involved in previous cases, impeded their movement out of State. They remain within Maryland in response to market forces, including that exerted by money from the State. Nothing in the purposes animating the Commerce Clause prohibits a State, in the absence of congressional action,[19] from participating in the market and exercising the right to favor its own citizens over others.[20] (Footnotes omitted)

Id., at 810.

The rule of *Alexandria Scrap* was followed by this Court in *Reeves, Inc. v. Stake, supra*, and *White v. Massachusetts Council of Const. Employers, supra*. In *Reeves*, this Court, relying on *Alexandria Scrap*, upheld against a Commerce Clause challenge a South Dakota policy to restrict the sale of cement produced by a state-owned plant to residents of the State. This Court left no doubt remaining regarding its belief that the rule it enunciated in *Alexandria Scrap* was correct:

> The basic distinction drawn in *Alexandria Scrap* between States as market participants and States as market regulators makes good sense and sound law.

447 U.S., at 436. In fact, even Justice Powell in his dissent expressly noted his agreement with the rule established in *Alexandria Scrap. Id.*, at 447, n.1, 451-452.

In *White*, this Court reaffirmed the rule of *Alexandria Scrap* in upholding a policy of the City of Boston which required private contractors to give hiring preference to city residents as a condition of obtaining public-funded construction contracts. This Court summarized the holdings of *Alexandria Scrap* and *Reeves:*

> *Alexandria Scrap* and *Reeves*, therefore, stand for the proposition that when a state or local government enters the market as a participant it is not subject to the restraints of the Commerce Clause.

460 U.S., at 208. Consistent with this general rule, the Court held that because the city was acting as a market participant, the Commerce Clause did not bar the residency conditions demanded by the city from participants. The impact of the policy on out-of-state residents was held to be relevant only if the city was regulating the market rather than acting as a participant.

Id., at 210. In determining whether the city was acting as a market participant, the Court held that where the city expended its own funds in entering into construction contracts it was a market participant. *Id.*, at 214-215. As in *Reeves*, the dissent in *White* expressly accepted the correctness of the rule in *Alexandria Scrap*. *Id.*, at 216.

The Ohio statutory scheme for encouraging the use of ethanol falls within the rule of *Alexandria Scrap*. Ohio grants a state-funded subsidy in the form of a tax credit to motor vehicle fuel dealers which use ethanol to make gasohol. This credit was intended as an incentive to encourage the use of ethanol as a substitute for lead in gasoline. Such a subsidy was necessary in order to make the use of ethanol competitive *vis a vis* gasoline because ethanol is more costly to produce than gasoline. JA 64-65, 73-77, 100, 147-149.

Ohio has not sought to prohibit the interstate flow of ethanol or to regulate the conditions under which it may occur.[4] Rather, like Maryland in *Alexandria Scrap*, Ohio has merely entered into the market to make the use of ethanol more attractive in the marketplace. Ohio is not regulating, it is exerting a market force. Even assuming that the challenged reciprocity provision has resulted in an impact on the interstate flow of ethanol, it is only because the market force exerted by Ohio has made it more lucrative for dealers to purchase ethanol from producers whose states provide ethanol credits similar to that of Ohio. This is the exact effect imposed by the Maryland scheme upheld in *Alexandria Scrap*. 426 U.S., at 806.

The tax credit provided to dealers by the Ohio statute operates in virtually the same manner as the Maryland bounty provided to scrap processors. Both involve the

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[4] No out-of-state ethanol producer is prohibited from selling its product in Ohio, nor are any conditions placed upon such producers' ability to so act in any regulatory sense.

expenditure of state funds in the marketplace as an incentive to effect a legitimate state purpose.[5] Neither interferes with the natural functioning of the interstate market by prohibition or burdensome regulation. The fact that the market force exerted by the Maryland scheme is in the form of a bounty while Ohio utilizes a tax credit is a distinction without a difference. While the form of the subsidy may differ, the substance is the same. In both cases, the state is spending its own money. Justice Stevens recognized this fact in his concurring opinion in *Alexandria Scrap*. 426 U.S., at 816. See also Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L.Rev. 1091, 1193-1194 (1986). Because Ohio is expending its own funds by granting tax credits to subsidize the use of ethanol, it was a market participant and thus falls under the rule of *Alexandria Scrap*.

There is another close similarity between the Maryland statutory scheme involved in *Alexandria Scrap* and the Ohio ethanol tax credit provision. The commerce which each of the provisions was claimed to have burdened was created, in whole or in substantial part, by the subsidies provided under those provisions. In his concurring opinion in *Alexandria Scrap*, Justice Stevens saw this feature as an additional basis for upholding the Maryland scheme. Justice Stevens did not believe that the Commerce Clause prohibited states from utilizing various methods to encourage local industry in a market which owes its existence to a state subsidy program. 426 U.S., at 815-816. Justice Stevens' reasoning for such a rule is compelling:

> The absence of any previous challenge to such programs reflects, I believe, a common and

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[5] The major distinction is the fact that the Maryland scheme admittedly favored Maryland processors over all out-of-state processors while the Ohio credit does not favor Ohio ethanol producers over all out-of-State producers.

> correct interpretation of the Commerce Clause as primarily intended (at least when Congress has not spoken) to inhibit the several States' power to create restrictions on the free flow of goods within the national market, rather than to provide the basis for questioning a State's right to experiment with different incentives to business.

Id., at 817. The majority opinion noted that had the facts in that case been clear on that issue it would have been inclined to so rule. *Id.*, at 809, n.18.

The interstate flow of ethanol which New Energy claims is burdened by the challenged reciprocity provision would not exist without the tax credit provided by Ohio. As New Energy's president admitted, without the credit ethanol could not compete with gasoline. JA 64-65, 73-77, 100, 149. Because the interstate commerce which New Energy claims is burdened by the reciprocity provision owes its existence, in whole or in substantial part, to the subsidy provided by the Ohio statutory scheme, that claimed burden does not fall within the strictures of the Commerce Clause.

II. Because Ohio Revised Code 5735.145(B) Is Not An Economic Protectionist Measure And Any Incidental Burden On Interstate Commerce Effected By The Provision Is Clearly Outweighed By The Local Benefits To The Health And Safety Of The People Of Ohio Advanced By The Legislation, The Provision Does Not Violate The Commerce Clause Of The United States Constitution.

A. Ohio Revised Code 5735.145(B) Is Not An "Economic Protectionist" Provision.

New Energy asserts that Ohio Revised Code 5735.145(B) discriminates against interstate commerce, thereby violating the Commerce Clause of the United States Constitution. In advancing this argument, New Energy relies on Commerce Clause cases considering statutes inapposite to Ohio Revised Code 5735.145(B). Because of this misplaced reliance, it is important to note at the outset what Ohio Revised Code 5735.145(B) does not do. It does not grant a credit solely for Ohio-produced ethanol (unlike the statutes struck down in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) and *Archer Daniels Midland Co. v. State*, 315 N.W. 2d 597 (Minn. Sup. Ct. 1982) (*"ADM Minn."*)). It does not tax the use of ethanol differently depending solely on whether the ethanol was produced in Ohio or out of Ohio (unlike the tax provisions stricken in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), and *National Meat Ass'n. v. Deukmejian*, 743 F. 2d 656 (9th Cir. 1984), *aff.* without opinion, 105 S.Ct. 768 (1985)). Nor does it operate to provide a direct commercial advantage to local ethanol producers over all out-of-state producers (unlike the tax provision declared invalid in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977)). Ohio Revised Code 5735.145(B) does not ban the sale of ethanol produced in other states from the Ohio market (unlike the statute stricken in *Philadelphia v. New Jersey*, 437 U.S. 617 (1978)), nor does it ban the sale of products manufactured in other states not having a reciprocal provision from the Ohio market (unlike the statute invalidated in *Great A & P Tea Co. v. Cottrell*, 424 U.S. 366 (1976)).

Ohio Revised Code 5735.145(B) does not operate in the same manner as any of the statutes involved in any of the cases relied on by New Energy. The statute simply provides that in order for ethanol produced in another state to qualify for the credit available to motor vehicle fuel dealers who use such ethanol in creating gasohol, the state in which the ethanol is produced must also provide similar benefits for ethanol produced in Ohio.

In considering the Commerce Clause challenge to this enactment the Ohio courts properly rejected the urging by New Energy to expand this Court's holdings in Commerce Clause cases beyond the factual

circumstances of those cases. The Commerce Clause does not stand as an absolute prohibition against all legislation having an effect on interstate commerce. New Energy's attempt to so color the Commerce Clause, and the cases decided thereunder, is belied by language in those very cases upon which New Energy relies:

> On various occasions when called upon to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case. *E.g., Freeman v. Hewitt, supra,* at 252, 91 L.Ed. 265, 67 S.Ct. 274. This case-by-case approach has left "much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation."

Boston Stock Exchange v. State Tax Commission, supra, at 329.

New Energy consciously avoids "the distinction established by this Court between 'protectionist' measures employed by states to favor local businesses and measures employed by states to safeguard the health and safety of their people." *National Meat Ass'n v. Deukmejian, supra,* at 659. It is only "protectionist" measures that are subject to a virtually per se rule of invalidity. Measures employed to safeguard the people of the state which have an incidental effect on interstate commerce "will be upheld unless the burden on such commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 142 (1970).

When the chaff is removed from New Energy's Commerce Clause argument what remains is the assertion that Ohio Revised Code 5735.145(B) is nothing more than simple "economic protectionism" enacted to favor local

ethanol producers at the expense of all out-of-state producers. However, New Energy was required to do more than merely assert that the statute was such a "protectionist" measure—it was required to establish this fact by the presentation of evidence. Each of the Ohio courts properly found that the enactment was not shown factually or legally to constitute "economic protectionism".

A finding that legislation constitutes nothing more than simple "economic protectionism" can be made only if it is demonstrated that it has a discriminatory purpose or a discriminatory effect. *Bacchus Imports, Ltd. v. Dias, supra,* at 270.[6] New Energy failed to meet its burden of establishing the existence of a discriminatory purpose or effect. It presented no evidence regarding the purpose of the General Assembly in enacting Ohio Revised Code 5735.145(B). It simply jumps to the conclusion that the purpose of the provision was to give a commercial advantage to local manufacturers of ethanol. This conclusion is supported neither by any evidence in the record nor by the face of the statutory provision. Based on the record and the statute, the holding of the Ohio Supreme Court that the enactment had neither a discriminatory purpose or effect is unassailable.

Unlike the Hawaiian statute struck down in *Bacchus* or the Minnesota ethanol credit stricken in *ADM Minn.,* Ohio Revised Code 5735.145(B) does not grant an exemption only to a locally produced product. In *Bacchus,* it was not disputed that the sole purpose of the exemption for okolehao and pineapple wine was to encourage and promote local industry. 468 U.S., at 270-271. Neither the Hawaiian exemption nor the Minnesota credit was

[6] A review of this Court's decisions indicates that the Court has been primarily concerned with discriminatory purpose and has looked at discriminatory effect as significant evidence of discriminatory purpose. See Regan, *supra,* at 1094-1098.

available to the same products produced in any other state.

Ohio Revised Code 5735.145(B) cannot logically be viewed as an attempt by the Ohio General Assembly to effectuate a discriminatory purpose by providing a commercial advantage to Ohio-produced ethanol. If that was the desire of the General Assembly, it would have enacted a provision that would restrict any tax credits solely to Ohio-produced ethanol or a direct subsidy program for Ohio producers. Rather, the General Assembly enacted Ohio Revised Code 5735.145(B) which provided a credit for gasohol created with ethanol produced not only in Ohio, but in any other state which granted similar ethanol use incentives.

Because of the vigorous competition among producers involved in the Ohio ethanol market, including large out-of-state producers whose ethanol would qualify under Ohio Revised Code 5735.145(B), the General Assembly was obviously aware of the fact that enactment of that provision would not give Ohio ethanol manufacturers a commercial advantage. Still, the General Assembly did enact Ohio Revised Code 5735.145(B). The reason it was enacted is because it was not intended to protect Ohio producers against out-of-state competition, but rather, to effectuate a legitimate state purpose.

It is common knowledge that leaded gasoline is one of the major sources of air pollution in this country. A primary purpose of the Ohio General Assembly in enacting Ohio Revised Code 5735.145 was to encourage the use of ethanol as a substitute for lead in gasoline. This purpose clearly advances the health and safety of the citizens of Ohio by providing a cleaner and safer environment. New Energy's repeated arguments below that no public health benefit is served by encouraging the use of ethanol as a substitute for lead in gasoline was belied by the testimony of its own president. Mr. Direnfeld testified that he agreed "that there are major health benefits to the public from the use of ethanol incorporated in gasoline

as opposed to the lead . . . .", JA 112, and that to encourage the use of ethanol as a substitute for lead in gasoline is a legitimate goal for both the federal and state governments. JA 112-113. New Energy also stipulated that ethanol was the most environmentally benign replacement for lead in gasoline as well as the most cost effective. JA 25, ¶10.

New Energy attacks the wisdom of the means chosen by the Ohio General Assembly to carry out its purpose of providing a safer environment by arguing that the ethanol produced in a state without a reciprocal credit is no less desireable from a public health standpoint than ethanol produced in a reciprocating state. This misses the point of why the provision is important to the accomplishment of the goal of providing a safer environment.

The goal is not simply to encourage use of ethanol in Ohio, but to encourage its use in other states, particularly those in close geographical proximity to Ohio. Encouragement of the use of ethanol simply by dealers within Ohio would only partially advance the legislative purpose. Unless ethanol is used in other states, including the five states which border Ohio, the purpose of providing a cleaner and safer environment in Ohio would be hindered. A significant number of motor vehicles of nonresidents travel in and through Ohio every day. Additionally, even if these vehicles are not driven in Ohio, they will still pollute the atmosphere which will reach Ohio.

Unless the states in which those residents live also provide incentives for the use of ethanol, it is unlikely that they will use the more environmentally benign ethanol mixture in their vehicles. This is so because, as the testimony of New Energy's president reveals, without both state and federal incentives ethanol producers cannot compete price-wise with gasoline. If gasohol cannot be priced equal to or less than gasoline its use will obviously suffer. It must be remembered that what is sought to be encouraged is the use of ethanol in not only Ohio but

also in the other states. The mere granting of a credit for use of ethanol blended for use in Ohio will do nothing to encourage such use in other states. If the fuel dealers in other states receive no credits for using ethanol, they will not do so because they will not be able to compete with dealers selling lower cost gasoline. In fact, without state incentive programs for ethanol, the industry itself is in jeopardy.

Even assuming that one of the purposes of the enactment was to promote the domestic ethanol industry, that would not by itself render the enactment invalid under the Commerce Clause. This was made clear by a recent statement on the subject by this Court. In *Metropolitan Life Insurance Co. v. Ward,* 470 U.S. 869, 876-877 n.6 (1985), this Court recognized that "promotion of local industry is a legitimate state interest in the Commerce Clause context . . . ." The Court reaffirmed that "a state may enact laws pursuant to its police power that have the purpose and effect of encouraging local industry" as long as it does not "impose a discriminatory burden upon the business of other States, *merely* to protect and promote local business." (quoting from *Bacchus,* emphasis added) *Id.* Similarly, in *American Trucking Associations, Inc. v. Scheiner,* 107 S.Ct. 2829, 2941 (1987), this Court noted that what the Commerce Clause prohibits is "a state tax that favors in-state business over out-of-state business *for no other reason* than the location of its business . . . ." (emphasis added).

Promotion of the local ethanol industry was clearly not the sole or primary purpose of Ohio Revised Code 5735.145(B). By its basic nature a reciprocity provision is not designed soley or primarily to favor domestic industry against all foreign competition. Ohio Revised Code 5735.145(B) clearly does not operate in a manner that "gives the home team an advantage by burdening all foreign corporations seeking to do business within the State, no matter what they or their States do." *Metropolitan Life Insurance Co. v. Ward, supra,* at 878.

Nor has New Energy met its burden of demonstrating that the challenged provision will have a discriminatory effect by causing Ohio-produced ethanol to gain a larger share of the Ohio market at the expense of out-of-state producers. New Energy has simply relied on cases in which the statutes in issue provided credits, exemptions or lower tax rates only for in-state activity. For example, in the *ADM Minn.* case, the statute granted a tax credit only for gasohol made with ethanol distilled in Minnesota and produced by agricultural products grown in Minnesota. No reciprocity was granted to ethanol produced in a state other than Minnesota. The same is true regarding the tax exemption invalidated in *Bacchus.*

Similarly, in *National Meat Association v. Deukmejian, supra,* the statute taxed all out-of-state beef processors and taxed no in-state beef processors. In *Armco,* the gross receipts tax exemption was available only to local manufacturers. The tax provision struck down in *Boston Stock Exchange* imposed a higher tax on security transfers resulting from out-of-state sales than on those resulting from in-state sales. In *Pike v. Bruce Church, Inc., supra,* the statute stricken required cantaloupe growers to pack their cantaloupes in Arizona. In *Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue,* 107 S.Ct. 2810 (1987), the Washington multiple activities exemption to its manufacturing tax results in a situation that "exposes manufacturing or selling activity outside the state to a multiple burden from which only the activity of manufacturing in-state and selling in-state is exempt." 107 S.Ct., at 2820.[7]

A common thread runs through each of these cases relied on by New Energy: the statutes involved in each case provided an advantage only to local industry which

[7] Significantly, in each of these cases the only discernible purpose of the challenged provisions was to advance local interests at the expense of out-of-state competitors. The effect of these statutes evidence that this was the purpose of those provisions.

resulted in a direct commercial advantage to such industry at the expense of all out-of-state competitors. This thread of unconstitutionality is not present in Ohio Revised Code 5735.145(B).

Ohio Revised Code 5735.145(B) does not operate on its face or in its practical effect to the disadvantage of all out-of-state ethanol producers. It does not provide a credit for only Ohio-produced ethanol. It is available for ethanol produced in any other state of the union which provides a similar credit or exemption for the use of ethanol. This is not just an appearance of availability designed to abort a Commerce Clause challenge, it is a fact. At the time of the enactment of Ohio Revised Code 5735.145(B), approximately thirty-two (32) states had some form of ethanol tax credit or exemption, including the State of Illinois where the largest producer of ethanol, ADM, is located. ADM, as well as Pekin Energy, which is also located in Illinois, and A.E. Staley, which is located in Tennessee, are all competitiors in the Ohio market and ethanol produced by each of these entities is entitled to the Ohio credit.

Because the tax provision involved in the cases relied on by New Energy were available only for local activities, they necessarily had a discriminatory effect against out-of-state activity. They did not operate even-handedly. Unlike those provisions, the Ohio credit is available for the use of out-of-state produced ethanol and is in fact being granted for such use. Therefore, Ohio Revised Code 5735.145(B) will not necessarily cause Ohio-produced ethanol to acquire a larger share of the market and out-of-state produced ethanol to constitute a smaller share. The fact that the provision may cause a shift in the Ohio market among out-of-state producers does not cause a discrimination against interstate commerce. *CTS Corp. v. Dynamics Corp.*, 107 S.Ct. 1637, 1649 (1987); *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 473 (1981); *Exxon Corp. v. Maryland*, 437 U.S. 117, 126-127 (1978).

As this Court noted in *Clover Leaf Creamery, supra,* at 474:

> We stressed that the Commerce Clause "protects the interstate market, not particular interstate firms from prohibitive or burdensome regulations." (quoting from *Exxon Corp.*, 437 U.S., at 127-128).

Under the proper Commerce Clause analysis, in order to meet its burden of demonstrating a discriminatory effect, New Energy was required to establish that the statute will cause locally-produced ethanol to gain a greater share of the Ohio market and ethanol produced out-of-state to constitute a smaller share of the market. *Exxon Corp. v. Maryland, supra,* at 126, n.16. See also *White v. Massachusetts Council of Constr. Employers, supra,* at 209, n.6. New Energy has failed to prove such an effect.

In fact, rather than demonstrating that the provision will have the effect of favoring the Ohio producer by causing it to gain a greater share of the market, the evidence established just the contrary. Out-of-state ethanol producers whose product is entitled to the Ohio credit when used in a qualified manner by motor vehicle fuel dealers are fully capable of supplying that portion of the Ohio market supplied by New Energy. There is nothing in the record indicating that the sole Ohio producer, South Point Ethanol, would be able to capture any new markets from these out-of-state competitors. What testimony there is indicates that ADM is the largest and most aggressive producer, from which the logical assumption would be that they would be the producer most likely to gain an increased share of the Ohio market if New Energy ceases doing business in Ohio. In fact, New Energy has not even established that the Ohio producer has the capacity to fill any void in the market. Unless it is demonstrated that South Point has the capacity to fill any new market, Ohio Revised Code 5735.145(B) cannot possibly be found to have a discriminatory effect.

Having correctly determined that Ohio Revised Code 5735.145(B) did not constitute "economic protectionism" but rather a measure designed to protect the health and safety of the citizens of Ohio, the Ohio Supreme Court properly balanced the purpose of the Commerce Clause and the legitimate interest of the state in safeguarding the health and safety of its people. Given the significant benefits that will be served by encouraging the use of ethanol and the incidental effect the statute may have on interstate commerce, that Court properly upheld Ohio Revised Code 5735.145(B).

B. Ohio Revised Code 5735.145(B) Does Not Impose An Absolute Ban On The Sale Of Ethanol Produced In Other States Regardless Of Whether Such States Grant Incentives To Ohio-Produced Ethanol; Therefore The Enactment Is Not Subject To The Strict Scrutiny Applied To Statutes That Impose Absolute Bans.

The State does not dispute that under the balancing test applied by this Court in Commerce Clause cases, "[o]nly state interests of substantial importance" will save a statute the implemention of which will result in an absolute ban on the interstate flow of a product. *Great A & P Tea Co. v. Cottrell*, 424 U.S. 366, 375 (1976). Contrary to New Energy's assertion, however, whether a statute imposes an absolute ban is relevant because it is important in applying the balancing test. As the Ohio Supreme Court correctly discerned, in the absence of such a ban the statute is not subjected to the strict scrutiny standard.

It is the absence of such a ban that distinguishes Ohio Revised Code 5735.145(B) from the provision stricken in *Great A & P Tea Co.*, the major case relied on by New Energy. The Mississippi provision imposed an absolute ban against the distribution of Louisiana-produced milk products in Mississippi unless Louisiana accepted Mississippi-produced milk on a reciprocal basis. Unlike the Mississippi reciprocity provision, Ohio Revised Code

5735.145(B) does not ban any product from the Ohio market. Any ethanol producer is free to sell its product to Ohio dealers. This fact distinguishes that case from the instant one, and the distinction is constitutionally significant because it directly changes the balancing test. Because Ohio Revised Code 5735.145(B) does not impose an absolute ban, it is not subject to the strict scrutiny applied in *Great A & P Tea Co.*

Additionally, Mississippi's contention that its reciprocity provision served a vital state interest was found by this Court to border on the "frivolous." *Id.*, at 375. While Mississippi argued that the provision maintained the State's health standards, the Court found that it in fact disserved this purpose because it would allow out-of-state milk to be distributed in Mississipi even if it was lower than Mississippi's standards as long as the state in which it was produced had entered into a reciprocity agreement with Mississippi. *Id.* In the present case, as the Ohio Supreme Court found, Ohio Revised Code 5735.145(B) advances a legitimate state purpose, a healthier and safer environment.

As this Court has repeatedly recognized, each Commerce Clause case requires a case-by-case analysis balancing the particular state interests involved and the interest in free trade among the states. *Boston Stock Exchange v. State Tax Commission, supra*, 429 U.S., at 329. Because the effect of the absolute ban imposed by the Mississippi statute on interstate commerce was "devastating" and the asserted state interest was found to border on the "frivolous", the balancing weighed heavily against the statute. Unlike the Mississipi statute, any incidental burden on interstate commerce resulting from Ohio Revised Code 5735.145(B) is clearly outweighed by the very real health and safety benefits advanced by the provision.

The reciprocity provision stricken in *Sporhase v. Nebraska*, 458 U.S. 941 (1982), was also subjected to the "strictest scrutiny" test because it too imposed an absolute

ban on the shipment of items in interstate commerce. The statute absolutely prohibited the shipment of water from Nebraska to any state which did not permit its water to be shipped to Nebraska. Significantly, in *Sporhase*, this Court expressly recognized the difference between economic protectionism and health and safety measures which are at the very core of the state's police power. However, because of the absolute ban imposed by the statute the state was required to show that the provision was narrowly tailored to serve that purpose. Because the Court found that it was not so tailored, the statute did not survive the "strictest scrutiny" test.

Because Ohio Revised Code 5735.145(B) does not impose a ban on the shipment or sale in Ohio of ethanol produced in any state, it is not subject to the "strictest scrutiny" test. Furthermore, as detailed earlier in this argument, Ohio Revised Code 5735.145(B) is a health and safety measure and is narrowly tailored to serve the purpose of protecting its citizens by encouraging measures which will directly result in a safer and cleaner environment. Because it is so tailored, the statute could survive the "strictest scrutiny" test, even assuming, *arguendo*, that it was applicable.

The statute at issue in *Baldwin v. G.A.F. Seelig., Inc.*, 294 U.S. 511 (1935), prohibited the sale of out-of-state produced milk in New York unless the price paid to producers was the same as that paid to New York producers. It, like the statutes in *Great A & P Tea Co.* and *Sporhase*, imposed an absolute ban unless other states complied with the statutory requirement. Additionally, the only plausible purpose of the provision was to protect the local milk industry. As such, it was simply an "economic protectionist" measure.

Brown-Forman Distillery v. N.Y. State Liquor Auth., 106 S.Ct. 2080 (1986), involved a statute virtually identical in effect to that stricken in *Seelig*. The purpose was to directly regulate commerce by regulating activities of businesses in other states. In effect, the statute regulated the price

at which these out-of-state distillers could sell their liquor in other states. The failure by those businesses to comply with that regulation could result in the revocation of the distiller's license to sell alcoholic beverages in New York. Simply stated, unless the distiller complied with the New York regulation, it could be absolutely banned from selling its goods in New York. Additionally, as was the statute in *Seelig*, the statute in *Brown-Forman* was found by the Court to be an economic protectionist measure.

Pike v. Bruce Church, Inc., supra, is also inapposite to this case. The statute involved in that case was found to have the effect of forcing growers to move their packing operations to the enacting state by prohibiting a grower from shipping its cantaloupes out of Arizona unless they were packed in Arizona. The Court noted that statutes requiring business operations to be performed in the home state were viewed with particular suspicion and that such a burden on commerce has been considered virtually per se illegal. 397 U.S., at 145. Ohio Revised Code 5735.145(B) contains no such requirement. It does not have the effect of forcing ethanol producers to locate in Ohio. In fact, as noted earlier, all of the major competitors other than New Energy continue to sell to Ohio dealers with no change or shifting in their operations. Additionally, unlike the grower in *Pike*, New Energy is not prohibited from shipping its product into Ohio.

Pike is also distinguishable because of the substantially different local interest sought to be advanced. The primary purpose of the Arizona legislation was to promote and preserve the reputation of Arizona growers, an interest which the Court labeled as "tenuous." 397 U.S., at 145. Balancing this "tenuous" state interest against the burden imposed on interstate commerce by requiring that a grower locate its business within the state, the Court found that the burden on interstate commerce was clearly excessive in relation to the local benefits.

It is particularly noteworthy that this Court distinguished this "tenuous" interest from legislation in the field of health

and safety "where the propriety of local regulation has long been recognized." *Id.*, at 143. The Court made it clear that the reason it struck down the legislation was due to the minimal nature of the state interest rather than the extent of the burden on interstate commerce:

> Such an incidental consequence of a regulatory scheme could perhaps be tolerated if a more compelling state interest were involved. But here the State's interest is minimal at best . . . .

Id., at 146.

Hunt v. Washington State Apple Advertising Commission, 432 U.S. 333 (1977), is similarly inapposite to this case. Initially, a reading of that decision reveals that there was at least a strong suspicion by the Court that the purpose of the challenged statute prohibiting any labeling containing state quality grades on closed containers of apples shipped into North Carolina was intended solely to give North Carolina growers a competitive edge. *Id.*, at 352-353. Second, the Court found that even if that was not the real purpose of the statute, the asserted purpose of protecting the consumers of the state was in fact disserved by the statute because it deprived them of all information regarding the quality of apples. Because the provision did not advance a legitimate state purpose, or did so only minimaly, the burden on the flow of interstate commerce resulting from the additional repackaging costs and the loss of the competitive advantage Washington apples held in the marketplace was found to outweigh that state interest.

Not only is any incidental burden imposed on interstate commerce by Ohio Revised Code 5735.145(B) less than that imposed by the Arizona or North Carolina legislation, but Ohio's interest in providing a cleaner and safer environment is a compelling state interest, unlike the tenuous interest of the Arizona legislation or the suspect

purpose of the North Carolina statute.[8] Additionally, unlike the statute in *Hunt*, Ohio Revised Code 5735.145(B) does serve to advance the legitimate state purpose of assuring a safer environment. The burden imposed on interstate commerce by Ohio Revised Code 5735.145(B) is not excessive in relation to the very real health benefits sought to be obtained by cleaning up the environment. Because the balance falls in favor of the enactment, the Ohio Supreme Court properly upheld Ohio Revised Code 5735.145(B).

[8] A review of this Court's decisions declaring invalid provisions imposing absolute bans on the interstate flow of goods reveals that a major factor underlying those decisions was the Court's belief that the purpose of those provisions was protectionist. That factor is not present in this case. See Part II. A., *supra*.

CONCLUSION

For the foregoing reasons, the judgment of the Supreme Court of Ohio should be affirmed.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Brief of Appellees, Joanne Limbach, Tax Commissioner of Ohio, Mary Ellen Withrow, Treasurer of Ohio, has been served by regular United States mail, first-class, postage prepaid, upon Herman Schwartz, Esq., 207 Myers Hall, 4400 Massachusetts Ave., N.W., Washington, D.C. 20016; David J. Young, Esq., Murphey, Young and Smith, 250 East Broad Street, Columbus, Ohio 43215, attorneys for appellant; and David C. Crago, Esq., 1900 Huntington Center, 41 South High Street, Columbus, Ohio 43215, attorney for appellee South Point Ethanol, on this _____ day of February, 1988. All parties required to be served have been served.

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